

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Oller Analyst: Norman Catelli Bill Number: SB 80
Related Bills: See Legislative History Telephone: 845-6117 Introduced Date: January 23, 2003
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Theft Loss Deduction

SUMMARY

This bill would modify the rules relating to a theft loss deduction to give a taxpayer the option to deduct the loss in the year the theft took place instead of the year it was discovered.

PURPOSE OF THE BILL

According to the author's office, the purpose of the bill is to aid taxpayers that are fraudulently induced into selling property and deprived of the proceeds. This bill will aid taxpayers that are victims of fraud because they may be subject to taxable income from the fraudulent transaction in the year the property was sold but under circumstances where the fraud is not discovered until a later year, when the deduction may not provide a tax benefit.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and would be operative for taxable years beginning on or after January 1, 2003.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Pursuant to Internal Revenue Code (IRC) Section 165, casualty and theft losses of non-business property are deductible subject to a \$100 floor per casualty or theft and an overall floor of 10% of adjusted gross income for losses exceeding casualty gains. Casualty is damage or loss of property from an identifiable event that is sudden, unexpected, or unusual. Theft is unlawful taking and removing of money or property with intent to deprive the owner of it.

California generally conforms to IRC Section 165, which allows, with some limitations, a deduction for a loss sustained during the taxable year that is not reimbursed by insurance or some other kind of compensation. The loss must be evidenced by closed and completed transactions, fixed by identifiable events, and actually sustained during the taxable year. Theft losses are treated as sustained during the taxable year in which the taxpayer discovers the loss.

Board Position:

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_____ N	_____ OUA	_____ PENDING

Department Director
Gerald H. Goldberg

Date
02/07/03

THIS BILL

This bill would give taxpayers a new option—to deduct theft losses in the year of the theft, even if the theft is not discovered until a subsequent year. This option is in addition to current law that limits the deduction to the year the theft is discovered.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

TECHNICAL CONSIDERATIONS

This bill uses the word “sustained” to mean the taxable year when the theft occurred. Current federal and state laws define “sustained” (IRC Section 165(e)) to mean the year in which the theft was discovered. The author’s staff indicates the bill is being amended to correctly reflect the intent of this bill. To inject certainty in the process, by eliminating any possible areas of conflict, it may be advisable to clarify the “option,” for example, by requiring an irrevocable election with respect to the taxable year the deduction is taken. Department staff is available to assist with amendments to resolve the technical concerns discussed in this analysis.

LEGISLATIVE HISTORY

SB 1602 (Oller, 2001-2002) contained a similar provision as this bill. SB 1602 was held in the Assembly Appropriations Committee.

OTHER STATES’ INFORMATION

New York, Michigan, and Minnesota conform to the federal casualty loss provisions. *Illinois* begins its tax base computation with federal adjusted gross income and does not allow itemized deductions, which precludes any casualty or theft loss deduction. *Massachusetts* allows some federal itemized deductions, but not a casualty or theft loss deduction.

FISCAL IMPACT

This bill would not significantly impact the department’s costs.

ECONOMIC IMPACT

Revenue Estimate

Annual revenue losses for this proposal are expected to be minor, not exceeding \$500,000

Revenue Discussion

The additional number of taxpayers who would qualify under this bill to report theft losses would not be significant. This proposal affects only those taxpayers that sustained a theft loss in a prior year without their knowledge and have not or will not be compensated for their loss by insurance or otherwise. Essentially, this proposal represents a timing issue. However, there are potential revenue losses if a taxpayer did not have income to offset the loss in the year the loss was discovered but did have income in the year the theft occurred.

Data available indicates that approximately 13,600 taxpayers reported casualty and theft losses that totaled \$145.2 million for tax year 2000. Information indicating what portion of this is due to theft losses is not available. However, due to the various natural disasters that occur in California each year (i.e. fire and flood), it is reasonable to assume the amount of casualty and theft losses reported are mainly due to casualty/disaster losses. Those taxpayers who would qualify to report the loss under current law conditions must further reduce the portion of taxpayers that would report theft losses pursuant to this proposal.

ARGUMENTS/POLICY CONCERNS

A policy concern exists because this bill creates an exception to the established tax doctrine that a loss must be identified by a "closed and completed transaction." In existing federal and state tax law, this concept generally means (1) that the theft has been discovered, (2) it is unlikely that the loss will be compensated, and (3) those facts are supported by identifiable events occurring during the taxable year. Under Section 17204.1(b) in the bill, the loss would be allowed in the year it occurred even if it had not been determined to be a "closed and completed" transaction as is currently required. Additionally, this bill would create differences between federal and California tax law, thereby increasing the complexity of California tax return preparation. However, based on a discussion with the author's staff, federal law may be changed to conform with this proposal.

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